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No. 82-716

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE EL PASO COMPANY,
Petitioner,
v.
UNITED STATES OF AMERICA, *et. al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

REPLY BRIEF

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REPLY BRIEF

I. THE COURT SHOULD HEAR THIS CASE ON THE MERITS.

A. This Case Presents the Full Range of Issues on the Tax Pool Analysis Question.

The issues of law and public policy raised by this case are of deep and immediate concern to all public companies subject to the financial reporting requirements of the securities laws. The United States has conceded in its brief that the tax pool analysis issue should be considered by this Court. Brief for the United States (hereinafter "Brief") at 13-14. The nine amicus curiae briefs filed

with the Court [1] by organizations with a combined membership of over a quarter million businesses, associations, and professionals further emphasize the importance and urgency of the questions posed by this case. We submit that there is a pressing need to resolve the conflict and confusion in the circuits regarding the tax pool analysis question, that the issues have crystallized and are ready for review, and that this case presents the overall question in the best posture for a complete resolution of all the issues involved.

Despite the clear need for a complete resolution of this question, the United States urges this Court to consider only half the problem. It argues that the Court should review the question whether tax pool analyses are privileged, but deny review on the parallel, and logically anterior, question of whether tax pool analyses are relevant under 26 U.S.C. § 7602, the statute granting the IRS summons authority. This approach would seriously handicap the Court in its consideration of the entire issue, since the relevance and privilege questions are closely interrelated.

No court which has considered the tax pool analysis issue has done so without addressing the relevance question,[2] nor should this Court. If the Court were to con-

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[1] Amicus curiae briefs urging the Court to grant certiorari in this case have been filed by: The American Gas Association; The American Petroleum Institute; The Chamber of Commerce of the United States; The Chemical Manufacturers' Association; The Interstate Natural Gas Association; Main Hurdman; The National Association of Manufacturers; The National Coal Association; and Tax Executives Institute, Inc.

[2] United States v. Arthur Young & Co., 496 F. Supp. 1152, 1156, *aff'd & rev'd*, 677 F.2d 211, 218-19 (2d Cir. 1982), *petition for cert. filed*, 51 U.S.L.W. 3341 (U.S. Oct. 20, 1982) (No. 82-687); United States v. The El Paso Co., Appendix to Petition for a Writ of Certiorari (App.) 11a-12a; United States v. Arthur Andersen & Co., 474 F. Supp. 322, 329-330 (D. Mass. 1979), *aff'd*, 623 F.2d 725, 729 (1st Cir. 1980); United States v. Coopers & Lybrand, 413

sider the relevance question and were to conclude that tax pool analyses are not relevant within the meaning of Section 7602, as the Tenth Circuit did in *United States* v. *Coopers & Lybrand*, 550 F.2d 615 (1977), it would be unnecessary to reach the privilege question. Moreover, if the Court failed to consider the relevance question and concluded that tax pool analyses are not privileged, the overall question of their amenability to IRS summonses would remain unresolved, since the question would surely arise again on the relevance issue. Thus, the approach the United States urges would, at minimum, hamper the Court's full consideration of this important issue and, at worst, constitute a waste of judicial resources and prolong uncertainty in the circuits.

B. This Case Presents the Issues as They Are Most Likely to Recur.

The United States requests the Court to hold this case pending ultimate disposition of *United States* v. *Arthur Young & Co.*, No. 82-687. However, we respectfully suggest that if one case or the other is to be held, the instant case should be decided and *Arthur Young* held. This is because the instant case presents the full range of issues likely to arise in a tax pool analysis summons case, including the relevance, work-product privilege and attorney-client privilege issues, whereas the Government has sought certiorari in *Arthur Young* only on the work-product privilege issue alone.[8]

F. Supp. 942, 946 *et seq.* (D. Colo. 1975), *aff'd*, 550 F.2d 615, 618-621 (10th Cir. 1977).

The First Circuit in *Arthur Andersen* found that the relevance issue was so significant to a resolution of the tax pool analysis question that it refused to consider it on the unsatisfactory record presented to it. 623 F.2d at 729. The instant case presents the tax pool analysis issue in a straightforward form, and provides a perfect matrix for a decision on this important issue.

[8] The cross-petition in *Arthur Young* focuses on important related issues, but not in the specific areas the courts have had the most difficulty resolving.

Moreover, this case presents the issues in the context in which they are most likely to recur. In *Arthur Young*, as in *Coopers & Lybrand*, the IRS summoned the tax pool analysis from the taxpayer's independent accountant, whereas in this case the tax pool analysis was prepared and retained in-house and was summoned from El Paso by the IRS. It is now clear that the majority of future IRS summonses for tax pool analyses will be directed to taxpayers rather than their independent accountants. This is because, subsequent to both the *Arthur Young* and *Coopers & Lybrand* decisions, the IRS announced a revision in its guidelines for revenue agents, requiring them to summon tax pool analyses from the taxpayer, rather than from its independent auditor, whenever possible. I Internal Revenue Manual (Audit) (CCH) § 4024.4(5) (1981).

While this shift in focus fails to resolve the problem, it does assure that this issue will occur most frequently in the future in the context of summonses issued to taxpayers rather than their independent accountants. Accordingly, if the Court wishes to address the issue in the context in which it is most likely to recur, it should consider this case on the merits and hold *Arthur Young* to await the ultimate disposition of this case. We continue to feel, however, that in view of the importance of the issues and the likelihood of their recurrence, the Court would be best served by hearing both cases.

II. RESPONSES TO SPECIFIC POINTS IN THE UNITED STATES' BRIEF.

A. There Is a Conflict in the Circuits Concerning the Applicable Standard of Relevance.

In the face of overwhelming authority to the contrary, the United States argues in its Brief that there is no conflict in the circuits on the question of the relevance of tax pool analyses to IRS investigations. Brief at 9. Its thesis is that neither *Cooper & Lybrand* nor *Matras* purports

to establish a legal standard governing the relevance of summoned material. Rather, it says, these cases involve mere "factual determinations." *Id.* at 10.

This argument is directly contradicted by the Second Circuit in *Arthur Young*, which expressly refused to accept the standard of relevance articulated in *Coopers & Lybrand* and *Matras*[4]. 677 F.2d at 218. The court thus recognized that *Coopers & Lybrand* and *Matras* had established a legal standard governing relevance, but disagreed with it. *Accord, United States* v. *Noall*, 587 F.2d 123, 126-127 (2d Cir. 1978), *cert. denied*, 441 U.S. 923 (1979); *Arthur Young, supra*, 496 F. Supp. at 1156. The court made no suggestion that either *Coopers & Lybrand* or *Matras* is confined to its facts, nor did the Fifth Circuit do so in this case. App. 11a-12a, 42a.

Moreover, the commentators on this question universally take the view that *Coopers & Lybrand* articulated a legal standard of relevance.[5] *E.g.*, Caplin, *Government*

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[4] United States v. Matras, 487 F.2d 1271 (8th Cir. 1973).

[5] In addition to the courts and commentators, a group convened by the Justice Department Tax Division itself has concluded not only that *Coopers & Lybrand* establishes a legal standard of relevance to be applied on a case-by-case basis, but that *Coopers & Lybrand* was correctly decided. Justice Department Tax Division's Advisory Group, *Report of the Committee on Standards for Seeking Accountants' Tax Accrual Workpapers* (May 1980). The Report stated:

> The members of the Committee agree with the decision in *Coopers*. All of the members of the Committee believe that if the I.R.S. were to prevail in such a situation there would be no effective restraint against a "fishing expedition" by the I.R.S. Indeed, the logical extension of the I.R.S.'s position in *Coopers* would be to require independent auditors who prepare tax accrual workpapers to disclose the taxpayer's "questionable positions." [Report at 4-5.]

The Committee unanimously disapproved the IRS's position in *Coopers & Lybrand* and recommended that the Tax Division adopt

Access to Independent Accountants' Tax Accrual Workpapers, 1 Va. Tax Rev. 57, 74, 80 (*Coopers & Lybrand* establishes a "variable relevance standard" with which the lower court decision on relevance in *Arthur Young* was in direct conflict); Robinson and Stoltenberg, *Privilege and Accountants' Workpapers*, 68 ABA Journal 1248, 1249-1250 (1982) (*Arthur Young* and *Coopers & Lybrand* in conflict over standard of relevance).

As the commentators observe, *Coopers & Lybrand* establishes the legal framework within which the facts of different cases may be analyzed. Its test is a balancing test which articulates several factors to be considered in weighing the facts of each case.[6] *Arthur Young*, the decision below in this case, and *Noall* disagreed with this standard, arguing that a much more sweeping construction of relevance was appropriate. Thus, there is a conflict on the question of which legal standard of relevance, the stricter or the more liberal, should apply. To emphasize, as the Government does, that before a determination can be made the chosen legal standard must be ap-

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the following standard, adapted from *Coopers & Lybrand*, in determining when to bring a summons enforcement action:

> The Justice Department's Tax Division will generally bring an enforcement action for tax accrual workpapers where there is a reasonable belief that the workpapers would disclose facts or circumstances relating to a particular transaction or transactions where such facts or circumstances are not otherwise available or apparent through normal audit procedure.

This Committee thus clearly recognized that *Coopers & Lybrand* does establish a legal standard of relevance. It is significant, however, that the IRS declined to follow the Committee's recommendation, thus forcing the issue that is now before the Court.

[6] These factors, set out in the District Court opinion, 413 F. Supp. 942, 949-954 (D. Colo. 1975), include such considerations as: whether the information sought consists of opinions and theories, not facts; whether the information sought was prepared in connection with the tax return; whether the IRS has a realistic expectation rather than an idle hope that something might be discovered; and others. *See* El Paso's Petition for a Writ of Certiorari at 12.

plied to the facts of each case is to do no more than state the obvious. The fact that there is a conflict in the circuits over the proper legal standard of relevance is not diminished because the test is a balancing test rather than a *per se* test. The Government's argument simply does not withstand scrutiny.

B. The Government Mischaracterizes the Relevance Issue.

Once it is recognized that *Coopers & Lybrand* presents a balancing test, it is apparent that no one of the factors articulated by *Coopers & Lybrand* need be determinative. For example, one factor *Coopers & Lybrand* identifies is whether the documents summoned were prepared in connection with the taxpayer's tax return. 413 F. Supp. at 950. Standing alone, the fact that the documents were not prepared in connection with the tax return may not be sufficient to support a ruling that the documents were not relevant to the IRS inquiry, although it undoubtedly would contribute to the balance against a finding of relevance.

Apparently misunderstanding this, the Government completely mischaracterizes El Paso's analysis of the relevance issue. Brief at 7-9 and 12 n.5. According to the Government, El Paso contends that because its tax pool analysis was not prepared in connection with its tax return, therefore it necessarily is not relevant. Nowhere in El Paso's Petition does it advance such an argument. Whether the information sought was prepared in connection with a return is only *one factor* to be considered in the overall balancing test established by *Coopers & Lybrand* and advanced by El Paso in this case (Petition for a Writ of Certiorari at 12), but neither El Paso nor the Tenth Circuit has argued that it is necessarily dispositive.

C. *Coopers & Lybrand* and *Matras* Have Not Been Overruled.

On page 12 of its Brief, the Government suggests that *Coopers & Lybrand* and *Matras* are no longer persuasive because a more liberal standard of relevance has subsequently been adopted by the Tenth and Eighth Circuits. One of the cases cited for this proposition appears to have no bearing on the issue at all. *United States* v. *Moon*, 616 F.2d 1043 (8th Cir. 1980). The other cites *Matras* as *authority* for its conclusion and fails to discuss *Coopers & Lybrand* at all. *United States* v. *City National Bank & Trust Co.*, 642 F.2d 388, 389 (10th Cir. 1981).

In *Moon*, the Eighth Circuit discussed neither *Matras* nor the "might throw light upon" standard. *City National Bank*, in the Tenth Circuit, involved a summons only for factual records. The IRS in that case sought bank deposit slips and similar records in an attempt to establish that payroll checks payable to taxpayers had been diverted to the bank account in question. These were factual records having a direct bearing on the tax liability shown on taxpayer's return, and the *Coopers & Lybrand* court would have agreed that the relevance requirement had been met. *See Coopers & Lybrand*, *supra*, 413 F. Supp. at 950; Caplin, *supra*, 1 Va. Tax Rev. at 65, 67, 74.

D. The Attorney-Client Privilege.

Although it concedes that the accountant work-product privilege argument is an important one which should be heard by the Court, the Government attempts in a footnote to dismiss El Paso's attorney-client privilege argument as unworthy of the Court's consideration. Brief at 14 n.6. Its first argument for this position is that the Fifth Circuit ruled that El Paso waived the privilege when it disclosed parts of the tax pool analysis to its independent auditors. But this is an argument *for* considering the attorney-client privilege question, since the

Fifth Circuit's waiver theory is directly contradictory to the Second Circuit's accountant work-product privilege. If a tax pool analysis is privileged in the hands of the taxpayer's independent accountant, as *Arthur Young* holds, then, as the Fifth Circuit itself recognized, "the taxpayer's revelation of tax accrual workpapers to an accountant should be considered a communication in confidence." App. 19a (footnote omitted).

The second argument, that El Paso failed to make a sufficiently specific assertion of the attorney-client privilege, is undercut by the fact that the Fifth Circuit found the language of the IRS summons, later incorporated in the District Court judgment, so unclear that it struck half of it. App. 8a-9a. El Paso asserted the attorney-client privilege at the very outset of these proceedings and has contended throughout that the imprecision of the summons concerning the material covered prevented an itemized assertion of the privilege. The Fifth Circuit's conclusion that much of the language of the summons was unclear in meaning underscores El Paso's dilemma—how to make a more specific assertion of privilege when it is unclear what documents have been summoned.

Under the circumstances, El Paso made the most specific assertion of the attorney-client privilege possible. The Government's failure to draft its summons more clearly should not foreclose El Paso from claiming the privilege.

CONCLUSION

This Court should grant certiorari on both questions presented in El Paso's Petition for a Writ of Certiorari and should consider the case on its merits.

Respectfully submitted,

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STATEMENT PURSUANT TO SUPREME
COURT RULE 28.1

Petitioner, The El Paso Company, reports, pursuant to Rule 28.1 of the Rules of this Court, that its listing of parent companies, subsidiaries (except wholly owned subsidiaries), and affiliates on page ii of its Petition for a Writ of Certiorari in this case should be amended to eliminate the Geonuclear Nobel Paso Company and the La Salle Terminal Company, both of which have been dissolved. Additionally, The El Paso Company notes that there currently is a tender offer outstanding for a substiantial portion of The El Paso Company's common stock. This offer by R. H. Holdings Corporation, a wholly-owned subsidiary of Burlington Northern Inc., is unopposed by The El Paso Company's board of directors. The offer expires February 7, 1983, unless extended.

The El Paso Company will make a further filing with this Court pursuant to Rule 28.1 at such time as its relationship with R. H. Holdings Corporation and Burlington Northern Inc. is clarified.

E. Barrett Prettyman, Jr.